

**Transcript of Remarks by Senator Kent Conrad (D-ND)
at Senate Budget Committee Hearing on Structural Deficits and Budget Process Reform
with Federal Reserve Board Chairman Alan Greenspan
April 21, 2005**

Opening Statement

I thank the chairman. And I thank the witness, Chairman Greenspan, for being with us, as well, today. I thought I'd just go through a brief review of where I see our fiscal situation and where I see it headed.

This is the history of the budget deficit since 2001. And we can see now we're at a record \$412 billion deficit in 2004. This graph shows some slight improvement. I wish it were so, but I don't believe it will actually occur.

If we look back to 1980 and look at the relationship between spending and revenue as a share of gross domestic product – which I think most economists, Mr. Chairman, would tell us is the right way to compare over extended periods of time – the red line is the spending line of the United States from 1980 to today, and then the dotted line projected going forward. The green line is the revenue line of the United States.

We can see the spending, as a share of gross domestic product, has come down quite substantially from the levels of the '80s and early '90s. And in fact, we got below 19 percent of GDP. We've had a tick-up now as a result almost exclusively of increases in defense and homeland security and aid for New York. And we see going forward basic stability with some increase, some slight further increase in spending as we go forward.

The revenue line – we can see when President Bush came in, revenue was at a historic high as a share of GDP. But look what's happened: The revenue side of the equation collapsed. And last year, revenue as a share of GDP was the lowest it has been since 1959. We see some slight improvement, but the projection going forward still leaves us at a revenue line that is far short of the traditional 20 percent that the Chairman outlined in his opening remarks, leaving us with this substantial gap – a very substantial gap – between spending and revenue going forward.

That gap is of special concern now, because this is before the baby boomers retire. This is the Comptroller General of the United States in a speech that he made to the National Press Club in February: "The simple truth is that our nation's financial condition is much worse than advertised."

I believe that. I think he's got it exactly right. I think the accounting system of the federal government misleads us. I think the language that we use about our financial condition misleads us. It misleads the American people. I think it probably misleads our colleagues. Perhaps we even mislead ourselves.

When the Comptroller General talks about the situation being worse than advertised, the President and his administration tell us that the deficit is going to get cut in half over the next five years. But the only way he gets there is he leaves out things. He leaves out war costs past September 30th. He leaves out the need to fix the alternative minimum tax, which is rapidly becoming a middle-class tax trap. He leaves out the cost of his Social Security proposal. When you add these things back in, the hashed red line is what we see happening going forward. He also only has the first five years of making the tax cuts permanent, when we all know that the second five years the cost of that proposal explodes.

So the harsh reality here is that our fiscal condition is not improving.

The President told us back in 2001 that, "My budget pays down a record amount of national debt. We will pay off \$2 trillion of debt over the next decade. That will be the largest debt reduction of any country ever. Future generations shouldn't be forced to pay back money that we have borrowed. We owe this kind of responsibility to our children and grandchildren."

And I agreed with that sentiment. I didn't believe that he was right that his budget would actually wind up paying down debt to that degree.

Let's match that prediction with what's actually happened. Because instead of paying down debt, the debt is exploding. The debt was \$3.3 trillion in 2001. We now anticipate a publicly held debt of over \$9 trillion by 2015. So debt is not being paid down. Debt is increasing dramatically: \$9 trillion by 2015.

When we look at the budget that is before us and we look at what it would do, this is the budget that was passed in the United States Senate, and these are the calculations of what it would do to the debt in each of the next five years. Debt goes up \$675 billion in 2005, \$651 billion in 2006, \$643 billion in 2007, \$644 billion in 2008, \$635 billion in 2009.

This is a not a budget that is improving our fiscal situation. The debt is going up each and every year under this budget by over \$600 billion.

The place where the Chairman and I agree is that we face a demographic tsunami because here's what's going to happen to us. This is the people eligible for Medicare and Social Security, and it's going to go from about 40 million to 80 million, and it's going to fundamentally change everything.

Comparing the long-term cost of Medicare and Social Security, [the Social Security and Medicare Trustees tell] us that the 75-year shortfall in Social Security is \$4 trillion; 75-year shortfall in Medicare, \$29.6 trillion – more than seven times as much. You know, the sooner we get at dealing with these long-term fiscal imbalances the better off our country will be.

My own judgment is – I have serious doubts about these forecast, by the way. I think the notion that over 75 years the economy is only going to grow 1.9 percent a year, highly questionable to me. Over the previous 75 years, the economy grew at 3.4 percent. If the economy grew in the same way it has in the past going forward, 90 percent of the Social Security shortfall would go away.

That does not mean we don't have a problem, and I think that's what's so hard to get across to people. Because even if the projections are wrong, we've got a serious budget problem. And we have a serious budget problem because those Social Security bonds have to be redeemed out of current income. And this demographic change is going to lead to enormous pressure on the budget, made much worse by the shortfall in Medicare and the size of the current deficits.

So we've got – even if these projections are wrong, which I believe they're overly pessimistic, we all just look back at the last 10 years, the Social Security actuaries told us 10 years ago going to run out of money in 35 years; 10 years later they tell us they're going to run out of money in 35 years. They underestimated economic growth.

But even with that said, we have a serious problem. And the sooner we deal with it, the better.

Questions and Answers

Conrad:

I thank the Chairman. I thank Chairman Greenspan for being here as well.

I think part of the frustration of many of us on this Committee is convincing our colleagues that there really is a problem. And they're probably not going to be convinced unless the American people are convinced. And it's very hard to convince people there is a real threat to our collective economic security when the economy seems to be doing reasonably well.

What would you say to the American people to convince them that there is a problem that requires action and that that action requires tough choices?

Greenspan:

I would first point out that the American economy is doing well, as you point out. We are effectively, as I said in my prepared remarks, in a demographic lull. Everybody knows there is a very large bloc of people currently employed in the workforce, producing goods and services for the whole community. With the inexorable turn of the calendar, they will retire and they will have an utterly unprecedented change in the society, where a huge number of people will be retired and be retired for a long period of time as longevity continues to increase.

Because of the very substantial shift out of the labor force into retirement, and because of the fact that the generation subsequent to the baby boomers was much smaller, the number of people who will be working producing goods and services for not only themselves and their families but for retirees as well, because remember when we talk in terms of dollar amounts of Medicare or Social Security, we're talking about dollars and claims to real resources – but in real time, all of those real resources are being produced by that workforce which is growing very slowly. And unless productivity accelerates at a pace far in excess of what we are currently projecting, there's going to be fewer goods and services to be distributed over a larger population.

Conrad:

What you're saying is people's way of life is going to be affected negatively.

Greenspan:

Correct.

Conrad:

Can I try to connect another dot here, because you made reference in your testimony about pressure on rising interest rates as a result of these collective deficits, build up of debt. I assume you're including our trade deficit circumstance as well?

Greenspan:

I'm just talking strictly in terms of the federal budget deficit.

Conrad:

Just in terms of the federal budget deficit, that this is going to put upward pressure on interest rates. Can you help people understand what the effect of rising interest rates might be on the strength of our economy, on what it would mean, for example, the housing market?

I heard the other day, Mr. Chairman, Chairman of the Committee, that a rise in interest rates – relatively modest rise – might lead to a rather significant reduction in home values in parts of the country because there's been such a run-up in those values.

Greenspan:

Well, a rise in interest rates per se need not do that. What history tells us is that a rise in interest rates will, one,

curtail new construction, because the monies that are borrowed for long-term assets in homes tend to be long-term assets – are very sensitive to what long term interest rates are. And it is also the case that the turnover of existing homes is itself a function of the interest rates.

And one would presume that, to the extent that the turnover and construction falls, there is – the reason for that is because demand is falling – that prices will certainly slow their very significant rate of increase. But it doesn't necessarily follow that they go down. They may, but that's not clear from the data. However, if you talk about an extraordinarily large rise in long-term interest rates, then, of course, one would have to envisage such an event.

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Conrad:

I go back to this chart that shows for a very long period of time the relationship between spending and revenue. And spending now is lower than it was through the '80s, as a share of GDP, through a good chunk of the '90s as well. It's the revenue side of the equation that has really fallen out on us. And although we see some uptick, the projections going forward still leave us with this enormous gap.

And I agree with you: longer term, the entitlements have got to be dealt with. I don't see it happening without a mix of spending and revenue. I mean, this revenue – last year is the lowest since '59 as a share of GDP.

When we look at revenue, I've been saying to my colleagues, before we talk about any tax increase to get additional revenue, that we ought to focus like a laser on the tax gap – the tax gap the Revenue Service now tells us, over \$330 billion for 2001. I believe, based on my experience, that the tax gap is very significantly understated.

Greenspan:

I'm sorry, are you referring to the fact of what we don't collect?

Conrad:

Yes. The tax gap being the difference between what is owed and what is being paid. And while the vast majority of Americans pay what they owe, the vast majority of companies pay what they owe, there are some who do not. And that amount of money has grown very significantly.

And you know well the schemes that are out there across America to dodge taxes. Every kind of aggressive accounting move that people have conjured up over the years is in play. I've got friends that are in major accounting firms. They tell me the culture has changed. And the Revenue Service's numbers show that this tax gap has grown significantly.

This isn't going to happen just on the spending side of the equation. It's just not. I personally believe that most of the adjustment or a very significant part is going to have to occur on the spending side because the numbers don't lie. The number of people eligible for Social Security and Medicare is going to grow dramatically and it would not be good for the economy to do this all on the revenue side of the equation. I don't think it could be done all on the revenue side. That argues, as you've argued here this morning very clearly, much of this must be done on the spending side.

But I also believe there are not going to be any agreements around here unless the revenue side of the equation is also addressed. And I believe the first place we ought to look is this tax gap. Would you comment on that basic notion?

Greenspan:

Well, Senator, I'm of firm belief that all legal obligations need to be paid and enforcement is required to sustain the law. Part of the problem, obviously, is lack of clarity in what the legal obligations are. And this is where you get this, sort of, vague notion between tax avoidance and tax evasion. And that legal line is not drawn as sharply as it should be. But there's no question in my mind if it is a legal obligation, the law needs to be enforced.